

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

RESPONDENT

Respondent.

Disciplinary Proceeding
No. 2011025622001

Hearing Officer—DMF

**ORDER DENYING RESPONDENT'S
MOTION FOR LEAVE TO PERMIT EXPERT TESTIMONY**

I. Introduction

On September 29, 2014, the Department of Enforcement filed a five cause Complaint against Respondent. On January 21, 2015, Enforcement filed an Amended Bill of Particulars clarifying and amending the allegations in the Complaint.

As clarified and amended by the Amended Bill of Particulars, the First Cause charges that Respondent failed to establish and maintain specific supervisory systems and written supervisory procedures that were reasonably designed to achieve compliance with the standards set forth in FINRA Rule 2330(d) regarding the supervision of Respondent's variable annuity securities business, and that these failures also caused Respondent to fail to comply with the general supervisory requirements set forth in NASD Rule 3010. The Second Cause, as clarified and amended, alleges that Respondent's supervisory principals did not have a reasonable basis to believe that certain variable annuity transactions that they approved were suitable for the customers, and that as a result, Respondent violated NASD Rule 3010 and FINRA Rules 2330(c) and 2010.

The Third Cause, as clarified and amended, alleges that in certain instances, Respondent failed to have a registered person review and determine whether he or she approved of the recommended purchase or exchange of a deferred variable annuity prior to the transmission of the customer's application to the issuing insurance company for processing, and as a result violated FINRA Rules 2330(c) and 2010. As clarified and amended, the Fourth Cause alleges that Respondent failed to implement surveillance procedures to determine if any of its associated persons had rates of effecting deferred variable annuity exchanges that raised for review whether such rates of exchanges evidenced conduct inconsistent with applicable provisions of FINRA

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Rule 2330, other applicable FINRA rules, or the federal securities laws, and failed to have policies and procedures reasonably designed to implement corrective measures in inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges. The Fourth Cause charged that Respondent thereby violated FINRA Rules 2330(d) and 2010. Finally, the Fifth Cause alleged that Respondent failed to develop and document specific training policies or programs to ensure that registered principals who reviewed variable annuity transactions had adequate knowledge to monitor for violations of FINRA rules, and as a result violated NASD Rule 2821(e) and FINRA Rules 2330(e) and 2010.

Respondent filed an Answer denying that it violated NASD and FINRA rules as alleged in the Complaint. A hearing is scheduled for the week of May 11, 2015.

II. Respondent's Motion and Enforcement's Opposition

On March 6, 2015, Respondent filed its Motion for Leave to Permit Expert Testimony. In the motion, Respondent seeks permission to call Elliot Server as an expert witness. The motion describes Server's experience in the securities industry until his retirement from Morgan Stanley Dean Witter in 2003 and as a consultant and expert witness since that time. A copy of Server's *curriculum vitae* is attached to the motion. According to the motion, Respondent proposes to have Server offer expert testimony regarding the following matters:

- The unique nature and structure of variable annuities;
- The customary supervisory systems and procedures that broker-dealers use to supervise variable annuity transactions;
- The industry process of registered principal review and approval of variable annuity transactions, including training, suitability review, monitoring, and compliance issues;
- Respondent's supervisory systems and written supervisory procedures regarding its variable annuity securities business were reasonably designed to assist in detecting and preventing violations of applicable rules, and achieving compliance with such rules;
- Respondent's system of two levels of registered principal review of variable annuities was reasonable, beneficial, and complied with applicable rules;
- The suitability review conducted by registered principals in the insurance department satisfied FINRA Rule 2330(c);
- The registered principals had a reasonable basis to approve the 13 transactions identified in Exhibit A to Enforcement's Amended Bill of Particulars;
- Registered principals were not required to consider exchange rates when reviewing particular annuity transactions; and
- There was adequate training to ensure compliance with the requirements of NASD Rule 2821(e) and FINRA Rule 2330(e).

In support of the motion, Respondent argues that the charges in the Complaint "involve[] issues of compliance with relatively new NASD and FINRA Rules governing variable annuities,

which are uniquely complex securities products” (footnote omitted). Respondent contends that “Server’s testimony would assist the Hearing Panel in understanding the nature and structure of variable annuity transactions, how such transactions are customarily reviewed and processed, key suitability considerations, and the industry practices for regulatory compliance and review of variable annuity sales.” While Respondent acknowledges that the Panel includes industry members, it argues that “the unique and complex nature of variable annuity transactions makes it appropriate to permit expert testimony regarding variable annuities,” and that the proposed expert testimony would “assist the Hearing Panel in understanding any potentially complex or confusing aspects of variable annuities in the context of this matter.”

Enforcement filed its Opposition to Respondent’s Motion for Leave to Permit Expert Testimony on March 27, 2015. Enforcement argues that:

this case does not require expert interpretation or explanation of complex variable annuity products (‘VAs’). This matter relates only to the adequacy of Respondent’s supervision of VA transactions, not to the underlying VAs themselves. Therefore, any testimony about the complexities of VAs is irrelevant. Additionally, FINRA Rule 2330 is not a new rule requiring expert testimony. It became effective in February 2010, and was a conversion from NASD Rule 2821. FINRA Rule 2330 provides clear and specific requirements for supervising VA sales that do not require expert interpretation.

In addition, Enforcement argues that “the proposed expert intends to testify about legal conclusions in an attempt to usurp the Hearing Panel’s role. Finally, the Motion should be denied because Respondent has failed to demonstrate that the proposed expert, Elliot Server, has special experience of expertise that the Hearing Panel lacks regarding the issues in this case.”

III. Discussion

Hearing Officers have broad discretion to accept or reject expert testimony in FINRA disciplinary proceedings.¹ The overarching and critical factor is whether the proposed testimony would be helpful to the Hearing Panel.² It is the proponent’s burden to show that the expert’s testimony satisfies the conditions for admission.³

In this case, Respondent has failed to satisfy that burden. As Enforcement points out, the issues in this case do not require a detailed examination of unusual or complex investment products, but rather an assessment of Respondent’s compliance with rules governing supervisory

¹ See *Department of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at *89-90 (NAC Oct. 28, 2002).

² See OHO Order 12-01 (2009018771602) (Mar. 14, 2012), <http://www.finra.org/sites/default/files/OHODecision/p126068.pdf>.

³ See OHO Order 12-01.

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requirements applicable to the sale of variable annuity products. Those rules are not particularly new, complex or unfamiliar. The Hearing Panelists, therefore, are fully capable of making the required assessment without any need for expert testimony. Moreover, several of the topics that Respondent identifies as areas the proposed expert would address are outside the scope of the issues in this proceeding or relate to ultimate issues that are not a proper topic for expert testimony, and insofar as the proposed expert would purport to address the practical application of the relevant rules, he has not been an active industry member for more than 10 years, while the industry Hearing Panelists are still active. For all these reasons, Respondent has failed to demonstrate that the proposed expert testimony would be helpful to the Hearing Panel.

IV. Order

For the reasons set forth above, Respondent's Motion for Leave to Permit Expert Testimony is **DENIED**.

SO ORDERED.

David M. FitzGerald
Hearing Officer

Dated: April 8, 2015